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SUBJECT: U.S. TRAVEL INDUSTRY CONCERNS ON IMPLEMENTATION OF  
U.S.-CHINA TOURISM MOU

(U) Sensitive but unclassified. Not for dissemination outside  
USG channels; not for Internet distribution.

11. (SBU) Summary: During August and September 2008 Shanghai  
Commercial Officer visited with executives of several U.S.  
travel and tourism firms active in the China outbound tourism  
market. Each of the executives expressed concern with recent  
trends in China's outbound tourism to the U.S. subsequent to the  
implementation of the U.S. - China Tourism MOU signed in  
December 2007. Each of the executives stated that National Tour  
Association-approved inbound operators or receptives in the  
United States are not realizing the benefits of a post-MOU  
increase in Chinese tour groups to the U.S. The executives  
attributed this to unfair actions on the part of the Chinese  
outbound tourism industry and unapproved actors in the U.S.  
market. Shanghai Consular Section Chief and NIV head  
acknowledged problems in MOU visa implementation and offered  
suggestions for solutions. End Summary.

#### Background

12. (SBU) In December 2007 the China National Tourism  
Administration (CNTA) and the U.S. Department of Commerce signed  
The Memorandum of Understanding between the Government of the  
People's Republic of China and the Government of the United  
States of America to Facilitate Outbound Tourist Group Travel  
from China to the United State. The MOU allowed Chinese leisure  
travelers to travel to the United States in group tours. China  
had previously not allowed its travel industry to organize or  
promote group leisure tours to the U.S. U.S. destination  
marketing organizations (DMOs) and travel firms had also been  
prohibited from promoting their states, cities or regions in  
China. The MOU removed those restrictions. The MOU was  
implemented on June 17, 2008, with an inaugural tour to  
Washington, D.C. led by CNTA Chairman Shao Qiwei.

13. (SBU) Since China's opening up to the outside world  
beginning thirty years ago, China has had a special policy to  
control and monitor outbound tourism, its Approved Destination  
Status (ADS) system. China negotiated bilateral ADS agreements  
with other governments to allow Chinese tour operators to  
organize tours to the counterpart country while the counterpart

government allowed Chinese tourists to travel into its territory with a special group ADS visa. As of 2008 China has ADS agreements with over 100 nations. The ADS system allows China to manage and monitor the flow of outbound tourism and hard currency. China controls the flow by two means:

- \* Chinese tour operators are not allowed to organize or promote group leisure tours to foreign destinations unless that destination country has signed an ADS agreement with China
- \* Foreign tour operators are not allowed to promote their services in China or open a representative office in China unless their country has an ADS agreement with China.

¶4. (SBU) Nonetheless, China and the U.S. were able to negotiate a unique tourism agreement as embodied in the 2007 MOU. While the agreement includes some aspects of the standard ADS agreement, it is not an ADS agreement and does not commit the U.S. to issuing group visas to Chinese citizens. The media and tourism industries both inside and outside of China often, erroneously, refer to the MOU as an ADS agreement.

¶5. (SBU) Another aspect of the ADS system that the U.S. was unwilling to accept was China's insistence that the counterpart country designate certain travel firms within its territory that would be allowed to accept ADS tours from China. Government selection of only certain firms to benefit from the tour business, while common practice in China, is contrary to the free market principles of the U.S.

¶6. (SBU) The negotiators settled upon a unique solution to China's desire to limit the inbound operators in the U.S. that could accept Chinese tour groups. The U.S. Department of

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Commerce would accept applications from travel organizations in the U.S. that were interested in vetting their membership for those firms capable of servicing Chinese tour groups. The first successful applicant, the National Tour Association (NTA), agreed to create a list of member firms willing to meet certain criteria such as on-staff Mandarin-speaking tour guides. The resulting list of firms is known commonly as the "NTA's approved list." Chinese outbound tour operators are required in the agreement to work with U.S. inbound tour operators and firms on this NTA list.

¶7. (U) On the China side the key regulator for tourism services is the China National Tourism Administration (CNTA), the Chinese government authority responsible for the development and regulation of tourism in the country. CNTA does not have the authority of a full department within the Chinese government but in other respects acts as a ministry. Provincial CNTA offices in each Chinese province report to the central CNTA in Beijing. CNTA has several overseas offices called CNTO (China National Tourism Offices) that are charged with promoting tourism to China. CNTA is unique as a tourism promotion agency in that it is also responsible for controlling the outflow of tourists from China abroad.

¶8. (U) CNTA licenses Chinese travel agencies to operate in up to three categories; Class 1: outbound international; Class 2: inbound international and Class 3: domestic only. Approximately 800 travel agencies in China have a Class 1 license and are legally able to offer outbound tours.

¶9. (SBU) Licenses to operate outbound travel agencies in China are so difficult to obtain that the license is itself a commodity. Some people obtain a license through connections and then rent out their "regional travel departments" to others who actually carry on the travel business. Some of the largest players in the Chinese outbound travel industry therefore don't show up on the CNTA's list of licensed travel agencies. In Chinese they are known as heima or "black horses" - the real players behind the scene.

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¶10. (U) As envisioned by the United States, the Tourism MOU was designed to open up the Chinese outbound travel market to the U.S. travel industry and boost the numbers of Chinese tourists visiting the U.S. The U.S. Department of Commerce's Office of Travel and Tourism Industries reports that January to June 2008 year-to-date arrivals from China (including Hong Kong) grew 33 percent to 305,654. According to the UN World Tourism Organization (UNWTO), China is the fastest growing travel market in the world. By 2020, China will become the world's fourth largest source of tourists. The U.S. Department of Commerce estimates that Chinese visitors to the United States will reach 579,000 by 2011. On average, Chinese citizens spend more during their stay than visitors from most countries. In 2006, the average per visitor spending by Chinese citizens traveling to the United States was more than \$6,000. Travel and tourism is the top service export for the United States and has produced a travel balance of trade surplus since 1989.

U.S. Inbound Operators Report No Increase in Tourists from China  
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¶11. (SBU) Commercial Officer spoke with seven U.S. inbound operators on the new NTA-approved list. Every one of the operators reported that they are yet to see any new business from China in 2008. One agency head reported that the one Chinese agency he had spoken to demanded 90-days credit - unusual terms in an industry where consumers pay in advance for the travel package.

¶12. (SBU) Three Los Angeles travel agencies with long histories in the Chinese-language tour market reported no increase in

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clients from China over last year's numbers. One reported that they are focusing on tour groups from the USA going to China because of problems getting visas for their China clients.

NTA-Approved Receptive Services Being Cherry-picked  
by Chinese Travel Agencies  
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¶13. (SBU) One large American-owned travel firm in Hong Kong reported that since June 2008 they have been approached by a number of Chinese outbound tour operators with requests for quotes on only the hotel and transportation portions of standardized tour itineraries. The Chinese indicated that they were providing the tour guides and interpreters themselves. The American firm has been unwilling to quote for only cherry-picked portions of these tour packages because their understanding is that NTA-approved inbound operators such as themselves are responsible for the entire inbound tour package and thus for anything that goes wrong with the tour. Without being in control of the inbound package in its entirety the American firm feels they run the risk of violating the terms of the MOU and of losing their NTA-approved status. Other U.S. tour agencies Commercial Officer spoke with confirmed that they have been approached in the same manner. Some declined to quote because they believed it would violate the MOU. Others quoted but failed to get the business because their prices were too high.

Unlicensed Chinese Outbound Operators Bypassing CNTA Licensing  
System  
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¶14. (SBU) Sources within the Chinese travel industry as well as the Consular Section in Shanghai report that Chinese travel agencies not licensed by the China National Tourism Administration (CNTA) for outbound sales are going through CNTA-licensed outbound operators to make Group Leisure Travel (GLT) appointments at U.S. Consular Sections in China. The licensed operators charge the unlicensed operators a fee for providing this service. This is similar to the common practice in China of licensed travel agencies illegally subleasing their license out to one or more unlicensed agencies.

¶15. (SBU) Although the unlicensed agencies are allowed to book their tour groups into the general group interview slots the agencies prefer the GLT slots because there is a perception among the Chinese agencies that the GLT slots are expedited, prestigious and more likely to result in approvals. However, records in Shanghai Consular indicate that approval percentages are actually higher during the general group interview slots.

¶16. (SBU) According to China's regulations, U.S. and other foreign travel agencies are not allowed to offer outbound travel services to Chinese citizens. This outbound business is reserved only for Chinese travel agencies licensed by CNTA. However, foreign travel agencies have skirted these Chinese restrictions on foreign firms by arranging partnerships with licensed Chinese agencies.

#### Consular Services Facilitation of Group Tours and MOU Implementation

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¶17. (SBU) Contrary to perceptions among most Chinese travel agents and citizens, U.S. Consular Service offices in China were facilitating group travel to the United States long before the December 2007 Tourism MOU was signed. While visa applicants have always had to qualify on an individual basis, Consular Services has long set aside General Group Interview slots for groups, including tour groups.

¶18. (SBU) After the MOU was signed in 2007 Consular Affairs in China created an additional category of interview slots known as Group Leisure Travel (GLT) slots. These were set aside exclusively for CNTA-licensed outbound travel agencies and operators. However, the Consular Section in Shanghai reports that fewer than 50 percent of the GLT slots have been utilized

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to date and plans are to cut back on the number of GLT interview slots. The Consular Section in Beijing also reported under-utilization of GLT slots.

¶19. (SBU) Consular Shanghai reports that Chinese travel agencies not on the CNTA-approved outbound operator list can continue to book their tour groups into the General Interview slots. Consular Shanghai reports that in August 2008 they processed 16,000 visa cases and issued 13,000 visas, refusing 2300 (about 16 percent). Shanghai also reports that they are issuing about 90 percent of visa applicants once pending documentation and/or re-interviews are taken into consideration. Shanghai has the highest rate of visa issuance among posts in China.

¶20. (SBU) Consular Shanghai reports that non-CNTA-approved travel agencies using the General Interview slots have a higher visa issuance success rate (90 percent) than do the CNTA-approved agencies (80 percent) using the GLT slots. In August there were 300 interviews in the GLT category and about 2000 in the General Group Interview category.

#### Large Deposits Required by Chinese Travel Agencies Impede Travel

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¶21. (SBU) In practice, almost all Chinese travel agencies require large monetary deposits from their clients before they can begin their overseas trip. The deposit is returned to them upon their return to China. Deposit amounts vary by destination. Travelers must deposit around US\$7,000 for Australia, US\$7,000-14,000 for Europe and US\$14,000-21,000 for travel to the USA. Clients need to deposit cash 5-15 days in advance of their travel day or 10 days in advance for a bank check. The tourist can collect the deposit with the receipt and passport one week after returning to China.

¶22. (SBU) Commercial Officer has been told by several Chinese travelers that they were under the impression that the deposits were required by the visa-issuing embassies and consulates. In reality, the large deposits are demanded by the travel agencies both as an incentive for the traveler to return and as a large

revolving fund that travel agencies can use to earn interest at banks or use to play the stock market. Since the travel agencies handle the visa applications for their clients the deposit is also used to discourage clients from canceling their tour or switching to another agency after they get their visa.

123. (SBU) The controversial deposits are a frequent topic on Internet chat rooms in China. Tourists are very unhappy with the deposits but it is an invisible rule among outbound travel agencies and there seems little that the consumers can do. One Chinese agency that advertised that no deposit was required found their shop windows smashed. China has no law governing tour deposits. CNTA authorities know this is a problem but have done nothing to change the situation.

#### Inbound Market in California Dominated by Brokers and Shops

124. (SBU) According to "ABC," the American-owned travel firm in Hong Kong, many Chinese outbound operators are bypassing the NTA Approved List and contracting directly with new entrants into the U.S. tourism industry - China-based tour brokers and shopping firms in California and elsewhere. The shopping firms in turn contract with hotels, bus companies and other suppliers. ABC's investigation of the market found that these shopping firms operate without indemnities, insurance, and other safeguards that are required by U.S. law.

125. (SBU) The Chinese outbound tour operator with a tour group in hand will go to the Chinese tour broker or inbound receptive agency which in turn shops the tour group around to the shopping firms (shops). The shop that will offer the cheapest price will be awarded the business. Shops make bids based on a "per head" basis - the average rate per head in Los Angeles is currently \$60 per-head. The shop then contracts the hotel, bus and tour guide. This amounts to an outsourcing of the entire receptive

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agency function. The receptive agency has essentially become a broker taking the spread between what the Chinese outbound operator offers them (about \$70 per head) and what the shops offer them (\$60 per head) for the tour group.

126. (SBU) ABC went to a number of the shops in Southern California and found that they were located off of the main streets in industrial and residential areas. Signage was absent or low-key and in many cases it was not apparent from the exterior that the buildings housed shops. The tour buses typically parked some distance from the shops. Once inside, the American travel executive discovered that the shops were stocked almost exclusively with pirated and knockoff products. This included famous brand shirts with a "made in USA" label sewn in, replica basketball uniforms, luxury brand watches and cosmetics, all obvious fakes to the trained eye according to ABC. Some legitimate but mass-market brand cosmetics and vitamins were being sold at highly inflated prices (up to ten times normal price).

127. (SBU) This practice mimics a common practice among tour agencies in China where tours are often comprised of repeated stops at stores where the tour operator receives a kickback for a percentage of goods purchased by their tour guests.

128. (SBU) The result of turning ultimate responsibility for the tour group over to these shops is that the tourists spend much of their time being herded into secluded shops where they are encouraged, sometimes pressured, into buying overpriced knockoffs instead of enjoying the tour of the United States they thought they were buying. The Chinese tourists victimized by this system are not having a quality experience and are probably returning to China with a very sub-optimal impression of the United States.

129. (SBU) This system bypasses much of the legitimate U.S. tourism industry and contributes little to the industry's prosperity. As a result, the new jobs and revenue the U.S. industry thought it was getting with the MOU have instead flowed



back to China.

¶30. (SBU) According to ABC's investigation the bus providers hired by these brokers are often unlicensed and uninsured. ABC also claims to have found that some of the bus drivers come with the tour group from China and serve as both (unlicensed) bus driver and tour guide. The cost of using an unlicensed driver from China is one-fifth the cost of using a licensed American driver. NTA-approved operators that observe the laws cannot compete with such illegal practices.

¶31. (SBU) This situation is not unique to the United States. Australia, Hong Kong, Southeast Asia and European countries that previously won ADS status have experienced similar problems. Many outbound travel agencies in China and their inbound partners offer low budget or even "zero-dollar" tour packages to Chinese tour groups and recoup losses by leading the tours to numerous shops from which they receive kickbacks or commissions.

¶32. (SBU) The abuse of the ADS system by Chinese outbound operators led Australia to overhaul their system in 2005 to stop Zero-Dollar practices. Only outbound and inbound tour operators who adhere to a strict Code of Business Standards and Ethics have access to the Australian ADS visa processing system.

#### NTA Approved List Not Being Disseminated by CNTA in Timely Manner

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¶33. (SBU) On August 22, Commercial Service (CS) Shanghai was contacted by NTA regarding complaints from some of their approved inbound operators that their firms had not yet been placed on CNTA's website listing of approved U.S. inbound operators.

¶34. (SBU) CS Shanghai suggested that NTA maintain a real-time list on the NTA website and ask CNTA to place a link on their website to the list on NTA's website - thus allowing NTA to

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provide a timely list to Chinese outbound operators. At NTA's request CS Shanghai contacted CNTA about the idea but were informed that such a simple solution would need to be formally incorporated into the MOU agreement. CNTA pointed out that the current agreement only called for list updates every six months.

The most recent, un-dated list of U.S. approved inbound operators can be found on the CNTA website at:  
<http://zhuanli.cnta.gov.cn/cjy/index.asp>

#### Consumer Education and the Chinese Tourist

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¶35. (SBU) The American travel agencies interviewed agreed that no one is forcing consumers in China to buy the low-budget or "zero-dollar" shopping tours but they all pointed out that Chinese consumers do not realize that they are buying tours without insurance and licensed drivers. They do not realize that they will be booked into hotels far from tourist attractions or that they will be forced to spend an inordinate amount of time in outlying shops that are not part of the American mainstream. As one Hawaii-based U.S. inbound operator with significant experience in China reported, "most of the Chinese retail tour agencies do not have experience selling tours into the U.S. market and those that do understand what's going on are more interested in quick turnover than in generating repeat business with satisfied customers."

¶36. (SBU) China is still an emerging market and Chinese travel agencies have limited travel products to offer clients. The agencies are further constrained by a lack of international knowledge, experience and budget. This has also lead to an absence of niche products and customized itineraries. This, in conjunction with the practices discussed here, may result in first-time Chinese tourists receiving a misleading picture of America.

#### Legitimate U.S. Travel Firms Cannot Compete

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¶37. (SBU) ABC and others have complained that contrary to expectations, the MOU has placed U.S. companies at a disadvantage in their own market. They also express concern that both governments are failing to police the agreement.

¶38. (SBU) On the Chinese side the CNTA is not policing the ranks of travel agencies in China to stop unlicensed outbound operators from organizing tours abroad. Neither is there evidence that CNTA is cracking down on the common practice of licensed travel agencies subleasing their licenses to unlicensed agencies that are in turn not held accountable for their often questionable practices.

¶39. (SBU) On the U.S. side there are jurisdictional gaps which allow the illegal operations to slip through cracks in enforcement. No federal agency is explicitly responsible for enforcing the provisions of the MOU. Once a State Department Consular Officer issues the visa, MOU enforcement becomes a question of domestic U.S. enforcement of immigration, IPR and civil laws.

¶40. (SBU) The Shanghai Consular Section has also pointed out another enforcement flaw. Prior to the signing of the MOU, travel agencies in mainland China were NOT able to advertise about tourism to the United States, nor officially organize groups. Government agencies were thus better able to police and monitor infractions. However, with a growing list of approved mainland China agencies able to now "advertise" U.S. tourism packages, enforcement of advertising and organizing by non-authorized travel agencies is lacking. In addition, small unauthorized travel agencies and authorized agencies have increased their advertising in the local media, which is generating more and more interest among Chinese travelers. Unauthorized GLT agencies are assisted by authorized agencies to make appointments as "GLT Participants" OR just assisting the traveler to make an appointment as a general B1/B2 traveler. The Consular Section in Shanghai has seen a large increase in

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people going to the United States for tourism in the Non-GLT appointment category.

#### Possible Solutions

¶41. (SBU) There are a number of possible solutions that could be implemented to address these problems.

-- Require Chinese outbound tour operators making group appointments at Consular Offices in China to submit a form or statement from an NTA-approved American inbound operator that is handling the inbound Chinese tour group in accordance with the MOU.

-- NTA could establish a liaison with California and other state and city commerce licensing units and a mechanism for reporting the locations of unlicensed shops selling counterfeit goods to tour groups. No one knows where these shops are any better than the NTA-approved inbound operators that have to compete with them.

-- Embassy and Consulate Commercial Sections could organize or facilitate consumer education exhibits and events at travel and tourism trade shows in China. The objective would be to inform consumers of the desirability of booking legitimate tours that provide licensed, insured transportation and quality services.

-- Development of a "single pipeline" system for making appointments and submitting visa applications for the GLT appointment category, allowing vetting on who is, and who is not, authorized to use the special travel channel. According to the Shanghai Consular Section, this would be similar to a system they already use for local Foreign Affairs Offices, as well as the American Chamber of Commerce. The single pipeline operator could be CNTA-authorized or an American firm operating the pipeline in a way that could benefit the U.S. industry as well as level the playing field among Chinese travel agencies.

